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No. 78-1030

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1978

SIDNEY EPSTEIN, ET AL.,

*Petitioners,*

*vs.*

DAVID L. GOODMAN, ET AL.,

*Respondents.*

## REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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## REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The Respondents' brief in opposition to the petition for certiorari ignores reality. Its assertion that this case involves nothing more than "a narrow point of law" concerning the Illinois statute of limitations (RB 5)[1] ignores the fact that the Seventh Circuit's decision raises crucial questions concerning the scope of Rule 10b-5 and the extension of the federal securities laws into internal partnership affairs regulated by uniform state statutes. Respondents' brief disregards the obvious impact of the Second Circuit's decision on limited partnerships—an investment vehicle used throughout the country for generating venture capital. The brief's claim that this case involves "a generally unimportant question of federal law" (RB 6) ignores this Court's repeated efforts to restrain federal courts from injecting Rule 10b-5 into

[1] Citations to Respondents' brief in opposition to the petition for writ of certiorari will be indicated as follows: "RB ."

areas traditionally left to state regulation. *See, e.g., International Brotherhood of Teamsters* v. *Daniel*, ____U.S.____, 47 L.W. 4135 (Jan. 16, 1979); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977); *Hochfelder* v. *Ernst & Ernst*, 425 U.S. 185 (1976); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975).

There is no judicial authority whatsoever for the Seventh Circuit's holding that each payment of a previously committed capital contribution to a limited partnership constitutes a new and distinct "purchase" and "sale" of a security under Rule 10b-5. As that court observed, Respondents have conceded that there is no precedent for their position. App. 19a.

Moreover, there is nothing in the language of the Securities Exchange Act of 1934 which supports the decision below. Sections 3(a)(13) and (14) of the Act, 15 U.S.C. §§78c(a)(13) and (14), which define the terms "purchase" and "sale", do not suggest that staggered payments made to discharge prior obligations constitute the purchase or sale of a security.[2]

With neither judicial nor statutory support, Respondents opposition to the petition for certiorari amounts to little more than the declaration that is "absurd" to deny that Rule 10b-5 applies to fraud allegedly committed by general partners long after a limited partnership has been formed, capital contribution commitments have been made, and all of the partnership interests have been distributed. (RB 9-10). Yet there is no logic in this assertion.

When a limited partnership is formed, all of the partnership interests are distributed at once among the

[2] Likewise, nothing in the detailed definitions in the parallel section of the Securities Act of 1933, 15 U.S.C. §77b(3), states or implies that capital contribution payments are purchases or sales of securities.



general and limited partners, in exchange for agreed upon consideration often including an initial cash contribution plus an unqualified commitment to contribute a specified amount of cash in the future. Subsequent payments of such committed capital contributions cannot possibly constitute additional purchases of securities, because there are no securities to purchase. All of the interests in the partnership were distributed when it was first formed. Each installment payment by the limited partners merely represents the fulfillment of an obligation previously created, not a "purchase or sale" of a security under Rule 10b-5. Because no new obligation is involved, any decision as to whether or not to make the required payments cannot involve an "investment decision." *See, e.g., Ingenito* v. *Bermec Corp.*, 441 F.Supp. 525, 534 (S.D.N.Y. 1977).

Finally, Respondents urge that absent the protective umbrella of Rule 10b-5, general partners could defraud limited partners "with impunity." (RB 9-10). This contention ignores state law which historically has regulated the internal affairs of limited partnerships. *Cf. Cort* v. *Ash*, 422 U.S. 66, 84 (1975). Far from "immunizing any fraud" occurring after formation of a limited partnership (RB 2), state common law demands of the general partners "the duty of the finest loyalty" and "[n]ot honesty alone, but the punctilio of an honor the most sensitive". *Meinhard* v. *Salmon*, 249 N.Y. 458, 463, 164 N.E. 545, 546 (1928) (Cardozo, J.). Additional protection, if any is needed, is provided by the Uniform Limited Partnership Act enacted in virtually every state.

There is no justification, much less a necessity, for employing Rule 10b-5 to federalize limited partnership law particularly where, as a result, established state regulatory policies necessarily will be overridden. *Cf. Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 479 (1977). Yet this, in reality, is what the Seventh Circuit's decision will do and this is why this case involves much more than "a generally unimportant question of federal law."

## CONCLUSION

For the reasons stated herein and in the petition for certiorari, we respectfully submit that the petition should be allowed.

Respectfully submitted,

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